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CHARLES ELMORE

No. [redacted] 7

IN THE

Supreme Court of the United States.

OCTOBER TERM, 1933.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER,

v.

WILLIAM ALBERT HARBISON.

BRIEF FOR THE RESPONDENT IN OPPOSITION TO THE PETITION FOR A WRIT OF CERTIORARI.

JAMES E. MACCLOSKEY, JR.,
HUGH SATTERLEE,
Counsel for the Respondent.

I

TABLE OF CONTENTS.

	PAGE
Opinions below	1
Question presented	1
Statutes and regulations involved	1
Statement	2
Argument	2
Appendix	7

TABLE OF CASES.

Atkins *v.* White, 3 Fed. Supp. 694, aff. —— Fed. (2d) —— (C. C. A. 1st Circ.), C. C. H. F. I. T. S. 1934, ¶,9185	4
Blow *v.* United States, 5 Fed. Supp. 737	4
Elkins *v.* Commissioner, 24 B. T. A. 572	3
Igleheart *v.* Commissioner, 27 B. T. A. 1426	4
Livingood *v.* Commissioner, 25 B. T. A. 585	5
Robinette *v.* Commissioner, 27 B. T. A. 1426	4
Straus *v.* Commissioner, 27 B. T. A. 1116	4
Westfeldt *v.* Commissioner, 63 Fed. (2d) 882	5
Woodward *v.* Commissioner, 27 B. T. A. 1426	4

STATUTES.

Revenue Act of 1928:	
Section 21	7
Section 22	7
Section 23	7
Section 101	8

REGULATIONS AND RULINGS.

Regulations 74, Article 501	9
I. T. 2104 (III–2 C. B. 152)	3
Mim. 3931 (XI–1 C. B. 33)	3
Telegram February 6, 1923 (C. C. H. F. I. T. S. 1924, Par. 2033)	3

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No. 888.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE,
Petitioner,
v.
WILLIAM ALBERT HARBISON.

BRIEF FOR THE RESPONDENT IN OPPOSITION TO THE PETITION FOR A WRIT OF CERTIORARI.

OPINIONS BELOW.

The opinion of the Board of Tax Appeals (R. 30–36) is reported in 26 B. T. A. 896. The opinion of the Circuit Court of Appeals for the Second Circuit is reported in 68 Fed. (2d) 1004.

QUESTION PRESENTED.

Where the taxpayer elects to be taxed under Section 101 (a) of the Revenue Act of 1928, does "net income," by which the maximum 15 per cent. deduction from gross income allowable for contributions under Section 23 (n) of the Revenue Act of 1928 is measured, include capital net gain?

STATUTES AND REGULATIONS INVOLVED.

The applicable provisions of the statutes and regulations involved are set forth in the appendix hereto.

STATEMENT.

The facts as stipulated and found are as follows (R. 22–24, 26–30, 43, 44):

The taxpayer during the taxable year 1928 had net income of $111,648.39, as defined by Section 21 of the Revenue Act of 1928, but before any allowance of a deduction for charitable contributions as provided for by Section 23 (n). Of such statutory net income $66,634.87 was ordinary net income and $45,013.52 was capital net gain, as defined by Section 101 (c). The taxpayer elected to have his capital net gain taxed under the capital net gain provisions in Section 101.

During the taxable year he made charitable contributions within the scope of Section 23 (n) amounting to $27,996.83. He claimed in his tax return, as a deduction for such charitable contributions, the sum of $16,747.26, which was equal to 15 per cent. of his statutory net income of $111,648.39 as computed without the benefit of the deduction for charitable contributions. The Board of Tax Appeals decided that his deduction for charitable contributions should be limited to 15 per cent., not of his net income, but of his ordinary net income. The Circuit Court of Appeals reversed the Board and held that the taxpayer's computation was correct.

ARGUMENT.

1. The statute provides (Section 23 (n)) that the 15 per cent. limitation shall be based on "net income." The Government's present contention is that, where the taxpayer elects to have his capital net gain subjected to tax under Section 101 of the statute, the 15 per cent. limitation shall be based on ordinary net income instead of net income, although it is not disputed that capital net gain is included in net income. The result of the Government's contention is a denial of the proposition that the whole is equal to the sum of its parts, because, according to the Government, the sum of capital net gain plus ordinary net income is not equal to, but exceeds net income. The fallacy in the Government's contention lies in attempting

to apply Section 101 before the net income, upon which the deduction for contributions is based, is determined under Sections 21, 22 and 23, and in failing to recognize that Section 101 provides only for the calculation of the tax and for the classification of net income, and not at all for the determination of net income. The Government confuses the two operations of the computation of net income and the computation of the tax.

The Government's excuse for its application for a writ of certiorari is that the Board of Tax Appeals rendered three or four erroneous decisions which it promptly overruled when its error was pointed out to it.

For a number of years the revenue acts have allowed a deduction from gross income for charitable contributions limited to 15 per cent. of net income before deducting such charitable contributions In the Revenue Act of 1921 provision was made for an optional tax on net gain derived from the sale of capital assets held over two years, and for the purpose of computation of such tax net income was divided into capital net gain and ordinary net income. In the Revenue Act of 1924 the provision was extended to apply to capital net losses.

Until 1932 the construction of the statute by the Treasury Department was consistent that both capital net gain and capital net loss, being part of net income, should be taken into account in determining the maximum deduction for charitable contributions. The Commissioner's position with respect to capital gains was first set forth in a telegram dated February 6, 1923 (C. C. H. Federal Income Tax Service 1924, ¶2033), and his position with respect to capital losses in I. T. 2104 (III-2 C. B. 152), promulgated in 1924.

On November 3, 1931, the Board of Tax Appeals held in *Elkins* v. *Commissioner*, 24 B. T. A. 572, that a capital net loss should be disregarded in the computation of charitable gifts. On January 27, 1932, in Mim. 3931 (XI-1 C. B. 33), the Commissioner stated:

> "The Board's decision is contrary to the position which the Bureau has consistently followed as announced in

I. T. 2104 (C. B. III-2, 152). The decision will be appealed, and in the audit of returns involving capital losses, the Bureau will continue to follow I. T. 2104."

Shortly thereafter the Board of Tax Appeals handed down decisions in the Bliss, Colgate and Harbison cases, now before this Court on applications for writs of certiorari, holding that capital net gains should be disregarded in the computation of the deduction for charitable contributions. The Commissioner thereupon embraced the benefits of these decisions and has since adopted a construction of the statute directly contrary to his practice uniformly followed since the enactment of the Revenue Acts of 1921 and 1924, the provisions of which were substantially reenacted in the Revenue Acts of 1926, 1928, and 1932.

On April 6, 1933, the Board of Tax Appeals in *Straus* v. *Commissioner*, 27 B. T. A. 1116, reversed its position in these cases, and held in accordance with the original construction of the statute by the Commissioner. Subsequently the Board rendered further decisions with respect to the inclusion of net gains in the computation of the deduction for charitable contributions, all in accordance with its decision in the *Straus* case. (*Robinette* v. *Commissioner*, 27 B. T. A. 1426; *Woodward* v. *Commissioner*, 27 B. T. A. 1426; *Igleheart* v. *Commissioner*, 27 B. T. A. 1426.) The District Court of the United States for the District of Massachusetts in *Atkins* v. *White*, 3 Fed. Supp. 694, and the District Court of the United States for the Northern District of Illinois, Eastern Division, in *Blow and Chatfield-Taylor, as Administrators*, v. *United States*, 5 Fed. Supp. 737, have held in accordance with the original position of the Commissioner and the present position of the Board of Tax Appeals. In addition to the Circuit Court of Appeals for the Second Circuit, which has reversed the Board's erroneous decisions in the *Bliss*, *Colgate* and *Harbison* cases, the Circuit Court of Appeals for the First Circuit has adopted the same position in affirming *Atkins* v. *White*, *supra*, —— Fed. 2d —— (C. C. H. Federal Income Tax Service 1934, ¶ 9185).

On the question now presented to this Court with respect to

the inclusion of capital net gain in net income for the purpose of computing the deduction for charitable contributions, there is, so far as we know, absolute unanimity of authority in the Board of Tax Appeals and in the United States courts, supported not only by the logical and reasonable construction of the statute, but by the construction and practice consistently and uniformly adopted by the Treasury Department from 1921 to 1932.

2. With respect to the question of accounting for capital net losses in the determination of net income, *Elkins* v. *Commissioner*, *supra*, 24 B. T. A. 572, and *Livingood* v. *Commissioner*, 25 B. T. A. 585, were decided before the reversal by the board of its erroneous position with respect to capital net gains and stand unaffected only because decided favorably to the taxpayers and because the Commissioner changed his original position. If, as is probably the case, capital net losses as well as capital net gains should be included in net income for the purpose of computing the deduction for charitable contributions, there is no occasion for this Court to pass separately on the question of capital net losses, but, if a difference exists in the case of capital net losses, that question is not now before this Court and can not conceivably be decided by this Court upon any review of a case involving only capital net gains.

3. A decision of this Court scarcely seems necessary to settle the confusion now existing in the administration of the provisions involved, such confusion being entirely due to the unwarranted abandonment by the Treasury Department of its original position. On the basis of the unanimous authority now existing, the Treasury Department can and should reinstate its original construction and practice of so many years standing. There is no conflict of authority which requires resolution by this Court.

4. The reference in the Government's petition in the *Bliss* case to *Westfeld* v. *Commissioner*, 63 Fed. (2d) 882, shows the weakness of its position. That decision was concerned with

an entirely unrelated provision of the statute, providing that income from a partnership subject to the rates in effect for the most recent calendar year should be added to the other income of the taxpayer subject to such rates, and it was held that the "other income" to which the partnership income was to be added was the ordinary income, excluding capital items taxable at a different rate. There was no question of "net income," which is specifically defined by the statute. An examination of the opinion in the Westfeldt case indicates how far the principle there enunciated is from conflicting with the decisions here in question.

CONCLUSION.

The decision of the Court below is correct and in accord with all existing decisions. No sufficient reason appears for its review by this Court. The petition should be denied.

J. E. MacCloskey, Jr.,
Hugh Satterlee,
Counsel for the Respondent.

April 12, 1934.

APPENDIX.

(Revenue Act of 1928, c. 852, 45 Stat. 791.)

TITLE I—INCOME TAX

PART II—COMPUTATION OF NET INCOME

SEC. 21. NET INCOME.

"Net income" means the gross income computed under section 22, less the deductions allowed by section 23.

SEC. 22. GROSS INCOME.

(a) **General definition.**—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

(Here follows a list of allowable deductions, including expenses, interest, taxes, losses, bad debts, etc.)

(n) **Charitable and other contributions.**—In the case of an individual, contributions or gifts made within the taxable year to or for the use of: * * *

(2) any corporation, or trust, or community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes, or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private shareholders or individual; * * *

to an amount which in all the above cases combined does not exceed 15 per centum of the taxpayer's net income as computed without the benefit of this subsection. * * *

SUBTITLE C—SUPPLEMENTAL PROVISIONS

SUPPLEMENT A—RATES OF TAX

SEC. 101. CAPITAL NET GAINS AND LOSSES.

(a) **Tax in case of capital net gain.**—In the case of any taxpayer, other than a corporation, who for any taxable year derives a capital net gain (as hereinafter defined in this section), there shall, at the election of the taxpayer, be levied, collected, and paid, in lieu of all other taxes imposed by this title, a tax determined as follows: a partial tax shall first be computed upon the basis of the ordinary net income at the rates and in the manner as if this section had not been enacted and the total tax shall be this amount plus 12½ per centum of the capital net gain.

(b) **Tax in case of capital net loss.**—In the case of any taxpayer, other than a corporation, who for any taxable year sustains a capital net loss (as hereinafter defined in this section), there shall be levied, collected, and paid, in lieu of all other taxes imposed by this title, a tax determined as follows: a partial tax shall first be computed upon the basis of the ordinary net income at the rates and in the manner as if this section had not been enacted, and the total tax shall be this amount minus 12½ per centum of the capital net loss; but in no case shall the tax of a taxpayer who has sustained a capital net loss be less than the tax computed without regard to the provisions of this section.

(c) **Definitions.**—For the purposes of this title—

(1) "Capital gain" means taxable gain from the sale or exchange of capital assets consummated after December 31, 1921.

(2) "Capital loss" means deductible loss resulting from the sale or exchange of capital assets.

(3) "Capital deductions" means such deductions as are allowed by section 23 for the purpose of computing net income, and are properly allocable to or chargeable against capital assets sold or exchanged during the taxable year.

(4) "Ordinary deductions" means the deductions allowed by section 23 other than capital losses and capital deductions.

(5) "Capital net gain" means the excess of the total amount of capital gain over the sum of (A) the capital deductions and capital losses, plus (B) the amount, if any, by which the ordinary deductions exceed the gross income computed without including capital gains.

(6) "Capital net loss" means the excess of the sum of the

capital losses plus the capital deductions over the total amount of capital gain.

(7) "Ordinary net income" means the net income, computed in accordance with the provisions of this title, after excluding all items of capital gain, capital loss, and capital deductions.
* * *

(Treasury Department Regulations 74, promulgated under the Revenue Act of 1928.)

ART. 501. **Definition and illustration of capital net gain.** —Section 101, which applies to sales and exchanges of capital assets consummated after December 31, 1921, provides that any taxpayer other than a corporation may, if he so desires, state separately in his return his net gain on sales or exchanges of capital assets, and pay on such capital net gain (as defined and limited in the section) a tax of 12½ per cent of the capital net gain in lieu of the tax he would otherwise pay on such income under sections 11, 12, 102, and 211. The tax upon his net income from other sources, termed "ordinary net income," is to be computed at the rates and in the manner provided in sections 11, 12, 102, and 211. The total tax will be the sum of the tax upon the ordinary net income plus 12½ per cent of the capital net gain. * * *